The Light

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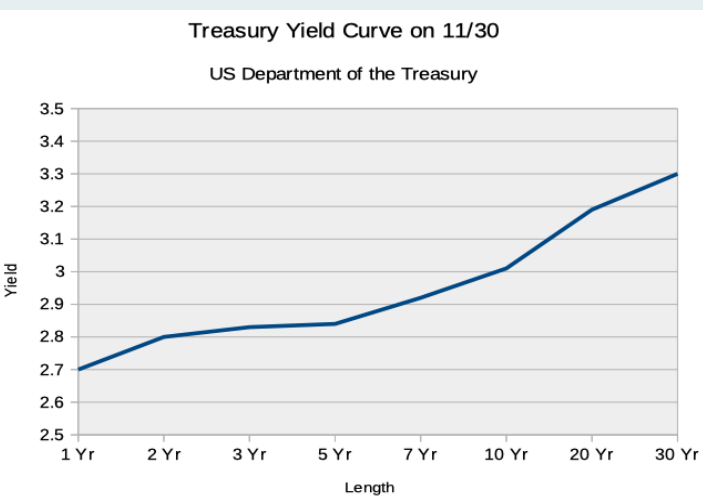
The Inverted Yield Curve—Does it Matter?

By Tim Rowsey, CPA, Investment Advisor Rep.

In recent weeks the news has been full of dire predictions of a coming recession. Much of this talk has been based on the recent inversion of the yield curve. We thought it would be valuable to look at this indicator and discuss what it might really mean.

First of all, what is the yield curve? The yield curve is a graph plotting out the yields of government bonds over various maturities. Typically, the curve shows the rates for 3-months, 2-years, 5-years, 7-years, 10-years and 30-years. Generally shorter term bonds pay a lower rate and long term bonds pay a higher rate so the slope of the line is upward. If the yield on a longer term bond is less than the short term bond, the curve is said to be “inverted”. A normal yield curve would look something like this:



On August 13th of this year the 10-year Treasury note yield fell below the yield on the 2-year note. This means that borrowers were paid more money for a 2-year note than a 10-year note. The 2-year Treasury bonds were yielding 1.603% while the 10-year Treasury bonds were yielding 1.6%. This is the first time that

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Debunking Common Social Security Myths

By Chris Bevington, CPA, Investment Advisor Rep.

Getting your head wrapped around something as complex as Social Security can be a challenging proposition. Misinformation, partially informed opinions, or a simple misunderstanding of the facts can lead to beliefs that are simply not true. We hear some of these common misconceptions enough that it makes it difficult to distinguish true facts from myth. Read on to help clarify fact from fiction.

Myth No. 1: Your benefits are only based on wages that you’ve earned prior to age 65.

How social security benefits are calculated may seem a mystery, but knowing a few key facts can clear up some common misconceptions. In general, to be eligible for social security you must have worked a minimum of 10 years of covered employment to “earn” the necessary 40 credits needed to qualify. Your benefit is calculated based on your highest 35 years of earnings. Earnings need not be in consecutive years or prior to age 65. In fact, if you work past age 65, those earning years would be included, assuming they are high enough to be included in your highest 35 years. Especially important to understand, if you are short of 35 years with earnings, *zeroes* are included in the calculation. When this is the case, even working part-time improves your benefit calculation replacing the zeroes with earnings.

Myth No. 2: Social security is going bankrupt.

This is a hot button, where some politician always seems to be pointing out how bad social security is, and how they’re the only candidate capable of fixing things to make everything right with the world again. There are obviously reasons for concern, but bankruptcy?? Here’s what’s really happening.

Social security is essentially a pay-as-you-go system. The money that comes in from taxes today goes to pay retirees today. Most everyone contributes 6.2% of each paycheck, and employers kick in an equal match. For many years, more people paid in payroll taxes than the system needed to pay out. The excess started to

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Inverted Yield Curve (continued from page 1)

this has happened since 2007.

The response of the stock market to this inversion was a dramatic 3% decline with the Dow Jones Industrial index falling 800 points. For many, the inversion of the yield curve is a predictor of a coming recession. It is true that before each of the recessions in 2000, 1991, and 1981 the yield curve did invert at some point prior to that recession. It is interesting to note that before the 2008 financial crisis, the yield curve inversion was early. It actually occurred on December 22, 2005 almost three years before recession.

There was also an inversion of a different curve, 5-year Treasury versus 3-year Treasury back in December of 2018. In a similar fashion the Dow dropped almost 800 points the next day. In both of these cases, the market recovered and moved back above the close before the inversion within a few weeks.

While it is certainly true that a yield curve inversion is a possible indicator of a future recession, this indicator is far from perfect. Sometimes all that happens is a slowdown of the economy. Some dismiss the warning of the yield curve saying that this time the inversion is caused more by the 10-year yield falling rather than the 3-month yield rising. In addition, if the Fed were to lower short term rates again in the near future, the inversion would probably disappear.

While at times a recession has followed a yield curve inversion, when it does it is typically at least 18 months later. Historically, the market rallies more than 15% on average in the 18 months following the inversion of the curve. If you look at the two recent inverted yield incidents last December and in August, both significant market declines were soon followed by recovery and additional growth in the market.

An inverted yield curve may be great at grabbing the attention of the financial press, however we believe that it is much more important to look at the overall economy rather than being spooked by one indicator that has not proven to be all that accurate. Many other indicators point to a continued strong economy that may keep the markets positive for several more years. ■

Myths (continued from page 1)

accumulate in the trust fund we hear so much about. But now, the worker to retiree ratio has started to shift. There is not enough money coming into the system to pay out to people claiming benefits. The shortfall is being made up by pulling from the trust fund.

If we are to believe what's generally being reported, the current trust fund balance is not expected to last even the next 20 years. Once it is gone, benefits will only be covered through payroll taxes being collected. That doesn't mean benefits will disappear altogether, but it could mean an estimated 20-25% reduction in benefits. Could such a reduction really happen? It's possible, but hard to imagine a scenario where Congress would allow it. As tough as it seems to be to confront difficult choices, Congress is not likely to risk upsetting millions of social security beneficiaries (read voters) proposing to make such significant cuts. Adjustments may come in some form of reduced benefits, an increase in taxes, or some combination of both. But social security is not going bankrupt, and will not just collapse and disappear.

Myth No. 3: you'll never get back all the money you **put into the program.**

While the government does not have a specific account set aside just for you, one of the most powerful features of social security is that it provides an inflation-protected retirement income stream. Even if you live to be 100 or more, you continue to receive income every month. And if you predecease your spouse, they also receive survivor benefits until his or her death. Depending on factors of when you start collecting, how long you live, etc., it is absolutely possible you will have paid in more than you ultimately collect. However, everyone's situation is different. If you live a long life, there's a good chance you may actually collect *more* than you contributed to the system. In fact, the amount of taxes paid in can often pale in comparison to the average amount of benefits paid out.

Myth No. 4: Illegal immigrants collect social security.

It's tough to imagine anyone who hasn't heard this misnomer. The belief that illegal immigrants can come to the United States and immediately receive Social Security benefits, is simply not true. In reality, although citizenship is not a requirement, immigrants must be lawfully present, *and* pay into the system for at least 10 years to qualify. In other words, if an individual doesn't obtain the proper work authorization, none of his earnings count towards qualifying for benefits. In short, immigrants have to follow the same eligibility requirements as everyone else.

Myth No. 5: Social security benefits are an earned right.

Although this would be really nice if true, social security payments are not guaranteed, and laws can be changed at any time that impact what you'll receive in benefits. In all honesty, this belief sounds logical, and the perception cast from past social security literature has been deceiving enough to make it seem as if true. However, the 1960 Flemming V. Nestor Supreme Court ruling makes it crystal clear:

"There has been a temptation throughout the program's history for some people to suppose that their FICA payroll taxes entitle them to a benefit in a legal, contractual sense. That is to say, if a person makes FICA contributions over a number of years, Congress cannot, according to this reasoning, change the rules in such a way that deprives a contributor of a promised future benefit. Under this reasoning, benefits under Social Security could probably only be increased, never decreased, if the Act could be amended at all. Congress clearly had no such limitation in mind when crafting the law."

This ruling leaves no doubt about an individual's "earned rights" when it comes to Social Security benefits. Benefits are based on current law. Congress has made changes to the law in the past and can do so again at any time. But under the same premise used above when considering significant benefit cuts, how likely is it that Congress is going to upset millions of voters by taking away that perceived right? In my opinion, it's not likely. Adjustments made? Sure. Increases to taxes in some way? Seems a near given. Stop benefits altogether? No chance. ■

Market Recap

How the major indices performed in the 3rd Quarter 2019

DOW JONES INDUSTRIAL AVERAGE			
3rd Quarter return	1.19%	YTD return	15.9%
S & P 500 COMPOSITE			
3rd Quarter return	1.26%	YTD return	19.3%
RUSSELL 2000			
3rd Quarter return	-2.95%	YTD return	14.1%
BARCLAYS AGGREGATE BOND			
3rd Quarter return	2.34%	YTD return	8.32%

*All indices are reported Total Return which includes Dividends

Market Update

By Greg Emmons, CFP®
Investment Advisor Rep.

Stocks edge up for the 3rd quarter

If you fell asleep for the last three months you wouldn't think much happened – although that wasn't actually the case. The DOW dropped a little over 7% from the end of July to mid-August only to climb back out of that hole, and then some, by the end of September. For the quarter the S&P 500 finished up 1.26%. We're still seeing the same themes move the markets with the US and China trade feud garnering most of the attention. The Federal Reserve also made news by cutting short term interest rates another 0.25%. Their intent is to ease things with the anxiety of a full out trade war with China and slowing growth in other parts of the world.

Bonds also up

Bonds also had a positive quarter. The Barclays Aggregate Bond Index was up 2.34%. The US 10 Year Treasury (an important bench mark for lending rates) experienced some volatility. We saw it at 2% in July but at 1.46% at the beginning of September and then bounce back to its current level at 1.7%. All in all, it was a very solid quarter for fixed income.

Year End Outlook

Despite how the various news outlets might make you feel, 2019 has been a fantastic year for the market. Now is a great time to make sure your investments line up with your goals and that you're taking on an appropriate level of risk for which you are comfortable. Investor sentiment has been pretty cautious, which historically is a good thing. When the investor world turns euphoric, and people feel that they can't miss, is when you want to be careful. Our stance is a little more defensive but we're still cautiously optimistic we can finish the year on a good note. ■

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